

GAO

Report to the Chairman, Subcommittee
on Military Readiness, Committee on
Armed Services, House of
Representatives

August 2000

DOD COMPETITIVE SOURCING

Some Progress, but Continuing Challenges Remain in Meeting Program Goals



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Abbreviations

DOD	Department of Defense
OMB	Office of Management and Budget



United States General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-285359

August 8, 2000

The Honorable Herbert H. Bateman
Chairman, Subcommittee on Military Readiness
Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

Since 1995, the Department of Defense has had a significant effort under way to use competitive sourcing under Office of Management and Budget Circular A-76 to achieve greater organizational efficiencies and reduce operating costs. In accordance with guidance contained in the circular, Defense components perform studies to determine whether it would be more cost efficient to maintain commercial activities in-house or contract with the private sector for their performance. The Department has recently subsumed its A-76 program under a broader initiative referred to as strategic sourcing,¹ expanding the number of positions to be studied and savings expected to be realized. The concept of strategic sourcing extends to activities that are considered to be inherently governmental² and involve a wide range of options, including restructuring or reengineering of activities, privatization, and the termination of obsolete services or programs. The strategic sourcing approach provides for a complete functional or organizational assessment of functions and activities, but initially does not involve competition between the public and private sectors. However, a function may become a candidate for A-76 study after being reviewed under the strategic sourcing program.

You asked us to review the Department's progress in implementing its A-76 program and the impact of strategic sourcing on the program. Accordingly, we assessed (1) progress the Department has made in achieving its A-76

¹While strategic sourcing includes A-76 studies, the Department commonly uses the term to refer to all reinvention efforts other than A-76. For purposes of this report, our reference to strategic sourcing will not include A-76 studies.

²The A-76 Supplemental Handbook defines an inherently governmental activity as "one that is so intimately related to the exercise of the public interest as to mandate performance by Federal employees." Positions deemed inherently governmental are not subject to the A-76 program.

goals and the extent to which strategic sourcing is affecting these goals and (2) the extent to which savings from A-76 and strategic sourcing are likely to be achieved. Our scope and methodology are included in appendix I.

Results in Brief

The Department has made progress in implementing its A-76 program, but it has not advanced as quickly as initially expected. While the goals have changed over time, the Department now projects studying activities which would encompass about 203,000 positions under A-76 during fiscal years 1997-2005. Also, because they could not identify activities with enough positions to study under the A-76 program, most of the Defense components are planning to use the broader strategic sourcing approach to meet some of the study goals previously associated with just the A-76 program. However, to date, only the Navy has identified specific strategic sourcing goals; it plans to review activities involving about 42,000 positions under this expanded program, including some positions previously targeted for A-76 studies. Because of the Navy's shift in emphasis, the Department is now planning to study activities involving about 25,000 fewer positions under A-76 during fiscal years 1997-2005—a reduction of about 11 percent of the 229,000 previously reported. The number of positions to be studied under A-76 during this period will likely decline further when other components submit their strategic sourcing plans. These decreases do not diminish the fact that the Department launched A-76 studies involving about 97,000 positions from fiscal years 1997-1999. However, the A-76 studies are taking longer than the expected average of 2 years to complete.

Our work continues to show that while savings are being achieved, the Department's savings estimates are overstated, at least in the short term,³ and that strategic sourcing has added to uncertainties regarding the overall magnitude of savings. The Department projects the A-76 program will generate savings of about \$9.2 billion during the period 1997-2005, with recurring savings of almost \$2.8 billion each year thereafter. Together, the A-76 and strategic sourcing study goals are expected to produce an estimated cumulative savings of almost \$11.7 billion, with about \$3.5 billion in recurring savings. However, these estimates do not fully account for costs associated with completing the studies or implementing the results, which will reduce the amount of savings realized in the short term. Also,

³For purposes of this report, we consider the short term to be until the program reaches a steady state of recurring savings.

delays in completing the studies will postpone the realization of savings. Further, officials from the Office of the Secretary of Defense emphasize that the estimated costs and potential savings of strategic sourcing efforts are difficult to project at this point. Nonetheless, Defense components have begun to reduce their operating budgets based on projected savings from these programs. In addition, the services are not planning to reduce military personnel end strength as a result of these studies. Rather, the services will reinvest military spaces freed up as the result of these studies in other areas where personnel shortfalls exist. This practice will make additional funding for operation and maintenance accounts necessary to fund replacement civilian or contractor personnel.

This report contains recommendations for improving the management of the A-76 and strategic sourcing initiatives. Overall, the Department agreed with the report while providing some clarifications regarding selected issues.

Background

Since 1955, the executive branch has encouraged federal agencies to obtain commercially available goods and services from the private sector when the agencies determined that such action was cost-effective. The Office of Management and Budget (OMB) formalized the policy in its Circular A-76, issued in 1966. In 1979, OMB supplemented the circular with a handbook that included procedures for competitively determining whether commercial activities should be performed in-house, by another federal agency through an interservice support agreement, or by the private sector. OMB updated this handbook in August 1983, March 1996, and June 1999. As part of this process, the government identifies the work to be performed—described in the performance work statement—and prepares an in-house cost estimate, based on its most efficient organization, and compares it with the winning offer from the private sector. From 1978-1994, competition decisions were split about evenly between the private and public sectors. (App. II contains a more detailed description of the A-76 process.)

Because of lengthy time frames previously required to perform cost comparisons, a provision was included in the Department of Defense (DOD) Appropriations Act for Fiscal Year 1991⁴ and in subsequent DOD appropriations acts requiring that single function competitions (under Circular A-76) be completed within 24 months and multifunction competitions within 48 months.⁵

Administrative and legislative constraints from the late 1980s through 1995, resulted in a lull—and even a moratorium—on awarding contracts resulting from competitions for a time. In 1995, congressional and administration initiatives placed more emphasis on A-76 as a means of achieving greater economies and efficiencies in operations. The Deputy Secretary of Defense in 1995 directed the services to make outsourcing of support activities a priority, and the effort subsequently was incorporated as a major initiative under the Secretary's November 1997 Defense Reform Initiative.

In recent years, some in Congress have also sought to encourage greater reliance on the private sector for commercial activities being performed by government employees. Accordingly, Congress enacted the Federal Activities Inventory Reform Act of 1998. The act directs federal agencies to submit to OMB by June 30th of each year an inventory of all their activities that are performed by federal employees but are not inherently governmental functions and to make their inventories public. Guidance implementing the legislation also permitted agencies to exempt many activities from competitive sourcing consideration based on legislative restrictions, national security considerations, and other factors.⁶

⁴Section 887, P.L. 101-511.

⁵A single function competition could, for example, involve studying the custodial services at an installation, while a multifunction competition could involve studying both custodial services and refuse collection and disposal services.

⁶DOD's initial Federal Activities Inventory Reform Act inventory identified 308,000 positions potentially subject to competitive sourcing consideration. Even then, as discussed later in this report, the location of these positions and the organizations to which they are assigned, and other factors, could affect how many of them are ultimately studied for potential contracting. We have a separate review under way that contrasts the Department's development of this inventory with an earlier effort under a Defense Reform Initiative Directive.

As we and others have reported,⁷ A-76 competitions can achieve savings regardless of whether the competitions are won by the public or the private sector. Savings may increase if multiple functions can be grouped together under a single contract, where appropriate, rather than under multiple contracts. Because the average military position is more costly than its civilian equivalent, greater savings may occur if DOD converts military support positions to civilian positions or contractor performance. However, we have also expressed caution about whether savings as large as the DOD has projected are likely to occur in the short term due, in part, to delays in launching and completing these studies and the need to offset up-front investment costs (such as the cost of conducting studies) before net savings begin to accrue on a recurring basis.

Guidance for completing A-76 studies is contained in OMB's Circular A-76 Supplemental Handbook, which is updated periodically. The March 1996 update clarified numerous areas, including the application of the A-76 cost comparison requirements. The handbook's introduction describes a wide range of options in addition to the A-76 process that government officials must consider as they contemplate reinventing government operations. They include consolidation, restructuring or reengineering activities, privatization, joint ventures with the private sector, and the termination of obsolete services.⁸

During fiscal year 1999, based on a request from the Navy—which was experiencing difficulty in identifying activities involving a sufficient number of positions to study under A-76 to meet its competitive sourcing goals—DOD approved use of the broader reinvention options noted above to complement the A-76 program. This larger program is commonly referred to as strategic sourcing.

Office of the Secretary of Defense and service officials stressed that neither the idea nor implementation of strategic sourcing is new—services have been conducting such reviews for years as part of their manpower management program. The officials stated that strategic sourcing provides for smarter decisions since it addresses the question of whether an activity should be performed before it answers the question of who should perform

⁷A complete list of recent GAO reports and testimonies dealing with DOD competitive sourcing is included at the end of this report.

⁸DOD includes all of these options in its strategic sourcing program.

it. However, the fiscal year 2001 President's budget is the first time that strategic sourcing efforts have been counted toward the goals of the A-76 program. Appendix III provides additional information on this expanded program.

A-76 Progress and Challenges

The Department has made progress in implementing its large A-76 program that uses competitive sourcing to gain economies and efficiencies in its operations and to reduce support costs. However, progress has not occurred as quickly as initially expected. Recognizing the difficulty in meeting study targets under A-76 alone, most of the services are planning to use strategic sourcing to help them meet the study goals previously associated with the A-76 program. DOD's fiscal year 2001 budget request projects studying 25,000 fewer positions under A-76 from fiscal years 1997-2005 than projected last year for fiscal years 1997-2003. However, when its current projections for the A-76 and strategic sourcing programs are combined, the Department's study goals are now about 16,000 positions greater than were planned last year under the A-76 program alone. To date, only the Navy has identified numbers of positions to be reviewed under strategic sourcing, but other Defense components are expected to do so in the future. This could further change the number and mix of positions expected to be studied under A-76 and strategic sourcing. While studies involving about 97,000 positions began in fiscal years 1997-1999, this is significantly less than planned. Studies involving only about 12 percent of these positions have been completed.

Study Goals Continue to Change

The Department plans to study and review functions involving over 245,000 positions in its expanded program for fiscal years 1997-2005, including 203,625 government positions under the A-76 program. While still a large program, this represents an 11-percent reduction over the Department's stated goal last year of studying functions involving 229,000 positions under A-76. At the same time, the Department's expanded program emphasis is based on the Navy having identified 41,879 positions to be reviewed under strategic sourcing, helping it to meet study and savings goals previously planned to be realized using only A-76.

Table 1 provides detail on the number of positions DOD plans to study under both the A-76 and strategic sourcing programs.

Table 1: DOD Positions Planned for A-76 and Strategic Sourcing Studies as of February 2000

	Fiscal year									
Component by program	1997	1998	1999	2000	2001	2002	2003	2004	2005	Total
A-76										
Army	14,176	11,909	11,630	12,910	14,781	5,726	0	0	0	71,132
Navy ^a	7,478	5,783	11,646	13,689	7,856	23	59	0	0	46,534
Air Force ^b	3,786	9,203	9,083	8,605	5,537	4,177	3,839	42	0	44,272
Marine Corps	0	0	2,583	2,300	2,300	0	0	0	0	7,183
Defense agencies	1,938	3,421	6,876	8,508	4,838	1,697	2,413	2,621	2,192	34,504
Total –A-76	27,378	30,316	41,818	46,012	35,312	11,623	6,311	2,663	2,192	203,625
Strategic sourcing										
Navy	0	9,177	13,961	12,435	3,691	1,365	1,250	0	0	41,879
Total—strategic sourcing	0	9,177	13,961	12,435	3,691	1,365	1,250	0	0	41,879
Grand Total	27,378	39,493	55,779	58,447	39,003	12,988	7,561	2,663	2,192	245,504

^aPositions for fiscal years 1997-1999 represent positions under study and differ from announced positions reported in table 2.

^bFigures do not include 10,000 positions from fiscal year 1993 through fiscal year 1996 that previously have been considered part of the Air Force's current efforts to achieve program savings.

Source: President's Budget for Fiscal Year 2001, exhibit 42.

Table 1 reflects reductions made to the Department's study projections for fiscal years 1997-1999 since fewer A-76 studies were launched than planned. For example, last year DOD projected it would study 52,630 positions in fiscal year 1998 and 60,113 in fiscal year 1999 but, as table 1 indicates, it has reduced those positions to 30,316 and 41,818 positions, respectively. About 82 percent of the positions (200,688) identified in table 1 are civilian positions, while about 18 percent (44,816) are military positions. The Army and Air Force each account for about 42 percent of the military positions to be studied.

Table 1 shows the Navy included strategic sourcing positions for review beginning in fiscal year 1998, although the Navy did not present its strategic sourcing plan to the Office of the Secretary of Defense until the fiscal year 2001 budget cycle. The Navy was allowed to retroactively include some reviews under this broader strategic sourcing program.⁹ This broader thrust came about as the Navy began to execute its A-76 program and officials had difficulty finding activities involving sufficient numbers of positions for study. For example, the Navy planned to announce 15,000 positions in fiscal year 1998, but announced only 8,980 (about 60 percent of planned). The Navy planned to announce 20,000 positions in fiscal year 1999, but announced just 10,807 (about 54 percent of planned).

Currently, the Navy plans to study activities involving 46,534 positions under A-76 from fiscal years 1997-2005, despite the fact that it had identified about 71,500 positions as eligible for competition under the Federal Activities Inventory Reform Act. However, Navy officials stated that the smaller number currently planned for A-76 study reflects the difficulties they had in ultimately determining how many positions could be studied. They stated that many of these positions were already part of other study initiatives, such as regionalization and consolidation. They also noted that other factors, such as geographic location and an inability to separate commercial from inherently governmental activities, can prevent the packaging of some commercial positions into suitable groups for competition. Navy officials therefore searched for another way to meet its goals.

As table 1 shows, the Navy plans to study activities involving 46,534 positions under A-76 and review activities involving 41,879 positions under strategic sourcing, for a total of 88,413 positions from fiscal years 1997-2005. For the Navy, this represents a net increase of about 8,000 positions over prior plans as reported in our February 1999 report,¹⁰ but a 42-percent reduction in positions expected to be studied under A-76 alone. Guidance issued by the Office of the Secretary of Defense¹¹ and by

⁹An Office of the Secretary of Defense official told us that the inclusion of strategic sourcing studies in fiscal years 1998 and 1999 was based on initiatives that were ongoing but from which projected savings had not been included in other programs.

¹⁰See *DOD Competitive Sourcing: Questions About Goals, Pace, and Risks of Key Reform Initiative* (GAO/NSIAD-99-46, Feb. 22, 1999).

¹¹"Strategic Sourcing Program," Department of Defense Strategic and Competitive Sourcing Program Interim Guidance, April 3, 2000.

the Navy¹² emphasizes that the strategic sourcing program is not intended to be a substitute or replacement for A-76; rather, it is intended to be a supplement to the A-76 program. Nonetheless, nearly half the total positions the Navy plans to study are under the strategic sourcing program and, in some instances, positions previously identified for study under A-76 have been shifted to strategic sourcing. A senior departmental official told us that strategic sourcing has changed the nature of the A-76 program and that, while the Department is still committed to conducting A-76 studies, strategic sourcing provides a broader approach to accomplish improved performance for an entire function or organization at a reduced cost.

The Army and the Air Force have also had some difficulty identifying enough positions to meet their A-76 goals. The Air Force sought relief through a broader reengineering proposal, similar to the Navy's, during the prior year's budget cycle, but Office of the Secretary of Defense officials told us the Air Force did not have sufficient justification at that time for them to approve the plan. However, Air Force and Army officials told us they may seek approval to use strategic sourcing next year for approximately 14,000 and 16,000 positions, respectively.

Large Numbers of Studies Are Under Way, but Progress in Initiating and Completing Studies Has Fallen Short of Expectations

In our February 1999 report, we reported that DOD expected to complete more A-76 studies over the next several years even though the services were experiencing difficulties in meeting the previous goals. A senior official in the Office of the Secretary of Defense agreed the program's goals are ambitious, but told us that it was important to keep the goals at a high level to ensure that the services strive to meet them. Even so, data show that the services and Defense agencies continue to have difficulties meeting their study goals. Table 2 provides information on the number of positions announced for study¹³ during the previous 3 fiscal years.

¹²"Strategic Sourcing: A Broader Approach--A Guide to Conducting Functionality Assessments" (Draft) Department of the Navy Strategic Sourcing Support Office (Jan. 2000).

¹³DOD considers a study to be announced once it has given notice to Congress of its intent to study a particular function at a particular location.

Table 2: Positions Announced for A-76 Studies

Component	Fiscal year			Total
	1997	1998	1999	
Army	13,739	11,909	11,334	36,982
Navy	10,663	8,980	10,807	30,450
Air Force	3,906	8,638	8,732	21,276
Marine Corps	0	0	3,722	3,722
Defense agencies ^a	365	2,152	2,264	4,781
Total	28,673	31,679	36,859	97,211

Note: In some cases, positions actually announced for study differ from initial goals or planned announcements cited in table 1 due to difficulties encountered in identifying activities at specific locations to be studied.

^aIncludes Defense Logistics Agency, Defense Finance and Accounting Service, and Defense Commissary Agency.

Source: Military services and Defense agencies from data available as of April 30, 2000.

The number of positions announced for study was about 65 percent of the number of positions planned for study during the 1997-1999 period (149,783), as reported in our February 1999 study. In addition to falling behind in its timetable for initiating A-76 studies, the Department has also had difficulties in completing its studies within the average 2-year goal it established for these studies. Table 3 shows the number of positions DOD reported were studied under the A-76 program.

Table 3: Number of Positions for Which A-76 Studies Have Been Completed

Component	Fiscal year			Total
	1997	1998	1999	
Army	32	235	987	1,254
Navy	94	200	1,858	2,152
Air Force	1,503	3,675	2,212	7,390
Marine Corps	0	0	0	0
Defense agencies ^a	357	299	316	972
Total	1,986	4,409	5,373	11,768

Note: Includes full studies, streamlined studies, and direct conversions for the military services. Also includes positions announced prior to 1997.

^aIncludes Defense Logistics Agency, Defense Finance and Accounting Service, and Defense Commissary Agency.

Source: Military services and Defense agencies from data available as of April 30, 2000.

A majority of these positions (8,558) reflect full cost comparison studies completed under the A-76 process. They also include 659 positions examined under streamlined cost comparison studies and 2,551 positions directly converted to or from contract performance without cost comparison studies, as authorized under A-76 guidelines.¹⁴

While precise comparisons between fiscal years is not possible, tables 2 and 3 provide an indication that Defense components are experiencing difficulties in completing their A-76 studies as planned. For example, studies involving nearly 29,000 positions were announced for study in fiscal year 1997; however, studies involving only 11,768 positions were completed from fiscal years 1997-1999. (Figures on studies completed during fiscal years 1997 and 1998 would also include studies that began before 1997.)

¹⁴The Circular A-76 Revised Supplemental Handbook provides streamlined cost comparison procedures that may be used for activities involving 65 full-time equivalent positions or less, and permits the direct conversion of a function with 10 full-time equivalents or less without cost comparison. Also, military positions may be directly converted without A-76 cost studies.

Overall Magnitude of Savings Is Overstated

While our work continues to show that the savings estimates are likely overstated, at least in the short term, the Department has revised its savings goals for A-76, combined them with projected savings from strategic sourcing, and increased its overall savings goal for the two initiatives. Although the Department is now giving greater recognition to the up-front investment cost estimates associated with its A-76 studies than it did last year, we believe these cost estimates remain understated and give an overly optimistic picture of savings likely to be realized in the short term. The Department also continues to have difficulties realizing its short-term savings because of delays in launching and completing A-76 studies. Further, prospects for long-term savings are clouded by what Department officials acknowledge are uncertainties over cost estimates and savings associated with strategic sourcing. Nonetheless, Defense components have begun to reduce their operating budgets based on projected savings from these programs. In addition, the services are not planning to reduce the end strength of their military personnel as a result of these studies, so no budgetary savings will be generated from studying military positions. Rather, because some of the functions previously performed by the military personnel will need to be performed by government civilian or contractor personnel, the result will likely be an increased requirement for the operation and maintenance budget accounts to pay for the civilian salaries or contracts. Some military officials expressed concern that this added cost could adversely affect their ability to meet regular operating requirements.

Savings Goals Revised and Expanded but Do Not Fully Account for Likely Impact of Investment Costs

We reported last year that DOD projected its A-76 program would realize nearly \$6 billion in savings for fiscal years 1997-2003, with over \$2 billion savings expected annually thereafter. More recently, the President's Budget for Fiscal Year 2001 expanded the time frame for completing its studies to 2005 and projected that cumulative savings for fiscal years 1997-2005 would be about \$11.7 billion—\$9.2 billion for the A-76 program and nearly \$2.5 billion for the strategic sourcing program. It projected that annual recurring savings from both (approximately \$2.8 billion from A-76 studies and \$0.7 billion from strategic sourcing studies) would total \$3.5 billion annually thereafter.

Table 4 provides the Department's current estimates of investment costs and cumulative net savings from A-76 and strategic sourcing from fiscal years 1997-2005.

Table 4: Estimated Study and Transition Costs and Savings From A-76 and Strategic Sourcing Studies for Fiscal Years 1997-2005

Dollars in millions

	Army	Navy	Air Force	Marine Corps	Defense agencies	Total
Study costs	94	317	60	18	66	555
Transition costs ^a	284	539	202	63	200	1,288
Cumulative net savings	2,786	5,169	1,739	311	1,680	11,685

^aTransition costs represent the costs to implement the A-76 studies, including separation costs.

Source: President's Budget for Fiscal Year 2001, exhibit 42.

The Department has increased its estimated study costs considerably since last year, and has given greater recognition to the estimated cost of implementing the results of the A-76 studies, including such costs as employee separation pay.¹⁵ Nevertheless, we found that the Department is, in some instances, still likely underestimating these costs.

A-76 Study Costs Are Underestimated

The President's fiscal 2001 budget projections for study costs for A-76 cost comparisons vary considerably by service, ranging from \$1,321 per position in the Army to \$3,718 per position in the Navy. Likewise, the amount of funding the services provide their subcomponents to conduct their studies also varies. Yet various officials believe these figures underestimate the costs of performing these studies.

¹⁵Only the Navy previously considered separation costs in calculating its savings estimates.

The Navy and the Air Force provide their subcomponents \$2,000 per position studied, while the Army provides \$1,500 per position, an amount scheduled to increase to \$2,000 beginning in fiscal year 2001. At the same time, various Defense officials told us that the cost of conducting these studies, which includes use of in-house personnel as well as costs of contractor personnel used to complete the studies, is much greater than these estimates. For example, officials at one Army major command estimated that their study costs would be at least \$7,000 per position. Another Army command estimated the cost could be as much as \$5,000 per position.¹⁶ One Navy command estimated its costs would be at least \$4,000 per position, while another command projected its study costs to be between \$8,500 and \$9,500 per position. Our own recent assessment of a sample of completed A-76 studies within the Army, Navy, Air Force, and Defense agencies showed that the costs ranged from an average of \$364 to \$9,000 per position studied.

A-76 Transition Costs May Be Underestimated

In addition to study costs, significant costs can be incurred in implementing the results of the A-76 studies. The President's Budget for Fiscal Year 2001 represents the first time all Defense components have estimated costs associated with implementing the A-76 competitions. The budget shows components have estimated a total of almost \$950 million for transition costs resulting from A-76 studies for fiscal years 1997-2005. This includes an estimate of \$284 million for the Army, \$400 million for the Navy, and \$202 million for the Air Force. While we view this as a positive step toward fully identifying costs associated with these studies, we believe these cost estimates may still be underestimated, depending on the number of studies completed.

Transition costs represent the separation costs for civilian Defense employees who lose their jobs as a result of competitions won by the private sector or when in-house organizations win the competitions and the most efficient organizations require a smaller civilian workforce. Such separation costs include the costs of voluntary early retirement, voluntary separation incentives, and involuntary separations through

¹⁶A U.S. Army Audit Agency report estimated that the cost of an A-76 study at one installation in this command was nearly \$5,000 per position for the first phase of the study. Phase I, completed from January 6, 1997, through September 30, 1998, ended with the receipt of industry proposals. Army officials told us these study costs are not representative of the whole Army; therefore, results of this study should not be generalized to the Army's entire A-76 program.

reduction-in-force procedures. Each service estimates the average cost per person separated. The Army estimates this average cost to be \$21,000; the Navy and Marine Corps, \$25,000; and the Air Force, \$33,000.

Unlike study costs, not all positions competed will incur a separation cost—this cost will only be generated if civilians are separated from federal service. Based on the results of prior competitions, the Department expects that about 50 percent of military and civilian positions studied under A-76 will likely be eliminated. However, our examination of DOD's fiscal year 2001 budget submission indicates that the services' estimates of the magnitude of civilian separations and transition costs associated with A-76 studies may be significantly underestimated.

Using the services' budget data, we calculated the number and percentage of positions for which the services estimated separation costs and compared it to the anticipated 50-percent separation rate mentioned above. We found that the Air Force had identified transition costs for only 24 percent of the civilian positions planned to be studied under A-76; the Army, 26 percent; the Marine Corps, 40 percent; and the Navy, 51 percent. Assuming the 50-percent separation rate continues, Army and Air Force transition costs could be nearly twice as much as their current estimates—assuming they complete their studies as planned.

Studies Are Taking Longer Than Planned and Will Likely Delay Savings

As previously noted, A-76 studies have taken longer than initially projected, which will also delay the onset of savings. From fiscal years 1997-1999, the services announced activities involving over 97,000 positions for study but had completed fewer than 12,000. While our work has shown that savings are being realized from individual A-76 studies, overall program costs to date are still exceeding realized savings.¹⁷ The President's Fiscal Year 2001 budget submission reports that during fiscal years 1998 and 1999, the overall costs of the A-76 program have exceeded the expected savings.¹⁸

An Army A-76 official acknowledged that A-76 studies have taken longer than expected, and consequently savings have been delayed. He said that

¹⁷We are now conducting a separate review examining the accuracy of the Department's savings estimates.

¹⁸The Air Force, which reported savings in fiscal year 1998, accounted for almost two-thirds of the completed studies as seen in table 3. The Air Force began many of its studies before 1997 and has realized savings, in part, because it is further along in the program.

instead of the expected savings of \$48 million for fiscal year 1999, the Army achieved gross savings of about \$22 million. However, the \$22 million savings estimate did not include transition costs, estimated to be about \$31 million, which created a shortfall of about \$9 million that year. Nonetheless, the official predicted that in the long run, the A-76 program would generate significant savings for the Department. Further, he said that the Army expects to see net savings during fiscal year 2000 or 2001.

In the meantime, however, the services' operation and maintenance budgets are being reduced in anticipation of projected savings from A-76 studies. Estimated savings are based on average cost of salary and benefits per position studied. The Army uses a factor of 20 percent per position planned for study when estimating savings; the Air Force uses 25 percent; the Marine Corps uses 30 percent. Half of the estimated savings are programmed out of the budget in the third year of the study, and the full amount is taken every year thereafter. The Navy previously used a factor of 30 percent, but officials told us they now develop individual estimates for each A-76 study. The Navy assumes these savings will begin in the third year after the studies are begun, and budgets are reduced accordingly.

In addition to delayed savings, the reported costs of the A-76 program have been higher than estimated, and commands have been absorbing these additional expenses out of their current budgets as well. Various service officials expressed concern about the impact of such reductions given their perception that they are already operating under constrained resources in relation to their operating requirements.

Expected Savings From Strategic Sourcing Are Uncertain

The Navy estimates that almost \$2.5 billion—nearly half its projected \$5.2 billion savings from fiscal years 1997-2005—will come from the strategic sourcing program. However, some departmental and service officials we met with expressed concern that fewer savings could be forthcoming from strategic sourcing and said they lack a rigorous basis for projecting costs and savings.

Department of Defense and Navy officials acknowledge much uncertainty over study costs and savings estimates for strategic sourcing. Data included in the President's fiscal year 2001 budget submission indicate that the Navy estimated that study costs and savings generated from strategic sourcing efforts are virtually the same as those generated from A-76 studies for each position studied. However, according to the budget submission data, strategic sourcing efforts are expected to result in manpower savings of less than 10 percent while A-76 studies are expected to generate manpower savings of 60 percent.¹⁹

Office of the Secretary of Defense officials acknowledged uncertainties over the projected costs and savings from strategic sourcing, saying that it would likely take some years before the results of strategic sourcing initiatives can be measured. They also noted that there is wide variation in the types of initiatives that make up strategic sourcing, and consequently, there can be wide variation in the resultant savings.

In general, Office of the Secretary of Defense and Navy officials expect that savings per position reviewed under strategic sourcing will be less than under A-76, primarily because fewer positions will be eliminated than if a decision to contract or implement the most efficient organization were made. Office of the Secretary of Defense officials expect that a larger number of positions will need to be reviewed to generate the same level of savings expected in A-76 studies.

Retaining Military Personnel Will Affect Costs and Savings

The Army, Air Force, Navy, and Marine Corps are planning to study activities involving a total of 44,816 military positions and will likely replace many of these military positions with government civilian or contractor personnel. Yet officials told us that regardless of the results of those competitions and functional assessments, none of the services plan to reduce the military end-strength levels resulting from these conversions.²⁰ Rather, the services plan to transfer the affected military personnel and their slots to fill other priorities.

¹⁹We calculated these costs and savings from data reported in the President's Budget for Fiscal Year 2001.

²⁰The Air Force intends to retain its military positions "until the variance between military requirements and military authorizations (funding) is minimal." Service officials do not know when this may occur.

We have previously reported that the conversion of positions from military to civilian (either government or contractor) as part of the A-76 process could save money, assuming that the elimination of the military positions results in corresponding reductions in the services' authorized end strengths.²¹ However, currently the services do not intend to eliminate these positions, but rather reallocate them to other areas where shortages exist (e.g., combat and combat support). While this practice can be considered a reasonable resource reallocation or reinvestment decision, it does have two practical implications for costs and savings. First, while such conversions are a relatively small part of the A-76 program at this time, such conversions will reduce the dollar savings available to reallocate to modernization needs since end strength is not being eliminated. Second, such conversions will require the services to increase their funding for operation and maintenance accounts, because it is from those accounts the services must fund replacement civilian or contractor personnel.²² For example, the Marine Corps, which plans to compete activities involving 915 military positions, estimates the cost to replace its military positions with government civilian or contractor personnel to be about \$35 million through fiscal year 2005. Various officials expressed concern about whether adequate replacement funds were being programmed in the operation and maintenance accounts.

Conclusions

The Department of Defense has established ambitious A-76 and strategic sourcing programs, and the effects of failing to achieve its goals could be significant. The Department is already reducing future operating budget estimates in anticipation of savings, and such reductions can create operational difficulties for service components. While savings are expected, DOD's anticipated savings projections have not adequately accounted for the estimated costs of conducting and implementing the studies, which could significantly reduce the anticipated level of savings in the short run. Also, cost comparison studies are likely to take longer than initially projected, further reducing the annual savings that will be realized in the short term. Consequently, the estimated savings from fiscal years

²¹See *Base Operations: Challenges Confronting DOD as It Renews Emphasis on Outsourcing* (GAO/NSIAD-97-86, Mar. 11, 1997).

²²The costs of military positions are funded through military personnel appropriation accounts, whereas costs associated with government civilian or contractor personnel are funded through operation and maintenance appropriation accounts.

1997-2005 are likely overstated. In addition, rather than eliminating military positions as a result of A-76 studies, the reallocation of military positions to other needs will necessitate increases in operation and maintenance accounts to provide funding for replacement government civilian or contractor personnel.

Because of difficulties in meeting its A-76 study targets, the Department is now permitting its components to complement this effort with its broader strategic sourcing initiative. While this expanded emphasis has the potential to achieve greater operating efficiencies than might have been achieved under A-76 studies alone, this initiative will likely require even more up-front investment costs which must be offset before net savings are realized. Results of these reviews will require close monitoring to provide a basis for more realistically projecting the time and resources required to complete those studies and to identify the magnitude and timing of savings likely to be achieved.

Recommendations

Considering the delays in implementing the studies and offsetting the initial investment costs, we recommend that the Secretary of Defense require DOD components to periodically determine if savings are being realized commensurate with the reductions being made in the operating accounts. We also recommend that the Secretary of Defense take steps to ensure that the services increase funding for operation and maintenance accounts, as necessary, to fund the civilian or contractor personnel replacing military positions that have been transferred to meet other needs.

Agency Comments and Our Evaluation

The Deputy Under Secretary of Defense (Installations) provided written comments on a draft of this report. Overall, the Department of Defense agreed with the report and generally agreed with the recommendations, while providing additional insights concerning savings involving military personnel. The Department also provided a number of technical comments, which we incorporated into the report, where appropriate. DOD's overall comments are included in appendix IV.

The Department agreed with our recommendation that DOD components should periodically determine if savings are being realized commensurate with the reductions being made in the operating accounts. In addition to sponsoring studies of savings from competitions, the Department noted

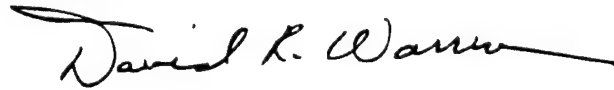
that it has efforts under way to develop Activity Based Cost accounting systems, which it believes will improve management oversight.

The Department partially agreed with the recommendation contained in our draft report that called for DOD components to adjust their savings estimates to reflect that military positions which are the subject of competitive sourcing and strategic sourcing studies will be retained and will not result in a reduction in authorized end strength. The Department noted that these military spaces are being reinvested in other areas where shortages exist in order to address readiness concerns. They acknowledge, however, that this practice will require the services to provide additional funding for operation and maintenance accounts to fund replacement government civilian or contractor personnel in implementing the results of the competitive and strategic sourcing studies. We have modified our recommendation to reflect the need for the services to provide such replacement funding.

We are providing copies of this report to Representative Solomon Ortiz, Ranking Minority Member, Subcommittee on Military Readiness, House Committee on Armed Services; and Senator James M. Inhofe, Chairman, and Senator Charles Robb, Ranking Minority Member, Subcommittee on Readiness and Management Support, Senate Committee on Armed Services. We are also sending copies of this report to the Honorable William S. Cohen, Secretary of Defense; the Honorable Louis Caldera, Secretary of the Army; the Honorable F. W. Peters, Secretary of the Air Force; the Honorable Richard Danzig, Secretary of the Navy; General James L. Jones, Commandant of the Marine Corps; and the Honorable Jacob Lew, Director, Office of Management and Budget. Copies will be made available to others upon request.

If you have any questions regarding this report, please contact me on (202) 512-8412. Other GAO contacts and other key contributors to this assignment are listed in appendix V.

Sincerely yours,

A handwritten signature in black ink, reading "David R. Warren". The signature is fluid and cursive, with a long horizontal stroke at the end.

David R. Warren, Director
Defense Management Issues

Scope and Methodology

The objectives of this report were to assess (1) progress the Department of Defense has made in achieving its study goals and the extent to which strategic sourcing is affecting these goals and (2) the extent to which savings from A-76 and strategic sourcing are likely to be achieved.

To evaluate the Department's progress in achieving its study goals and savings estimates, we met with the Deputy Under Secretary of Defense for Acquisition Reform, the Deputy Under Secretary of Defense for Installations, and representatives from their offices. We also contacted the Office of the Under Secretary of Defense (Comptroller and Chief Financial Officer) regarding the movement of money from the operation and maintenance account to other accounts. We obtained and analyzed the planning assumptions each military service and Defense agency used. Working with headquarters officials from each of the services and Defense agencies, we obtained information on the numbers of positions planned for study, which they used as the basis for projected savings from fiscal years 1997-2005. We obtained data on past, ongoing, and future A-76 studies from the services and Defense agencies and estimates on savings and costs. We gathered and analyzed information on the number of A-76 full competitions, streamlined cost studies, and direct conversions. We considered a cost study to be completed when an award was made to a contractor or the final decision was made to keep the function in-house.

To assess the impact of the strategic sourcing program, we met with responsible officials from the Office of the Secretary of Defense, the Army, the Air Force, the Navy, and the Marine Corps. We also contacted officials from the Defense agencies. We gathered information on plans, timetables, goals and objectives from Navy officials. However, the Army and Air Force were in the planning stages of their strategic sourcing programs, and could offer little information on their objectives and timetables. The Marine Corps had no plans to participate in strategic sourcing. Therefore, our work was limited regarding this objective.

We performed our work at the Office of the Army Assistant Chief of Staff for Installation Management, Pentagon; the Army Materiel Command, Alexandria, Virginia; the Office of the Chief of Naval Operations, Logistics, Pentagon; the Office of the Assistant Secretary of the Navy (Financial Management, Comptroller), Pentagon; the Naval Sea Systems Command, Arlington, Virginia; the Air Force Directorate of Manpower and Organization, Pentagon; the U.S. Marine Corps; and the Office of the Secretary of Defense. We contacted officials at the Defense Finance and Accounting Service, Arlington, Virginia, and the Defense Logistics Agency,

Fort Belvoir, Virginia. We also visited and performed work at the Army Forces Command, Atlanta, Georgia; the Army Training and Doctrine Command, Fort Monroe, Virginia; the U.S. Atlantic Fleet, Norfolk, Virginia; the Naval Air Systems Command, Patuxent River, Maryland; the Naval Surface Warfare Center, Crane, Indiana; the Air Force Air Education and Training Command, San Antonio, Texas; and the Air Force Materiel Command, Dayton, Ohio.

During the course of our study, many of the numbers changed, in part, because of delays in reporting. Data provided in this report represent information available as of April 30, 2000. We expect the numbers may change again, so what we reported may not represent final figures.

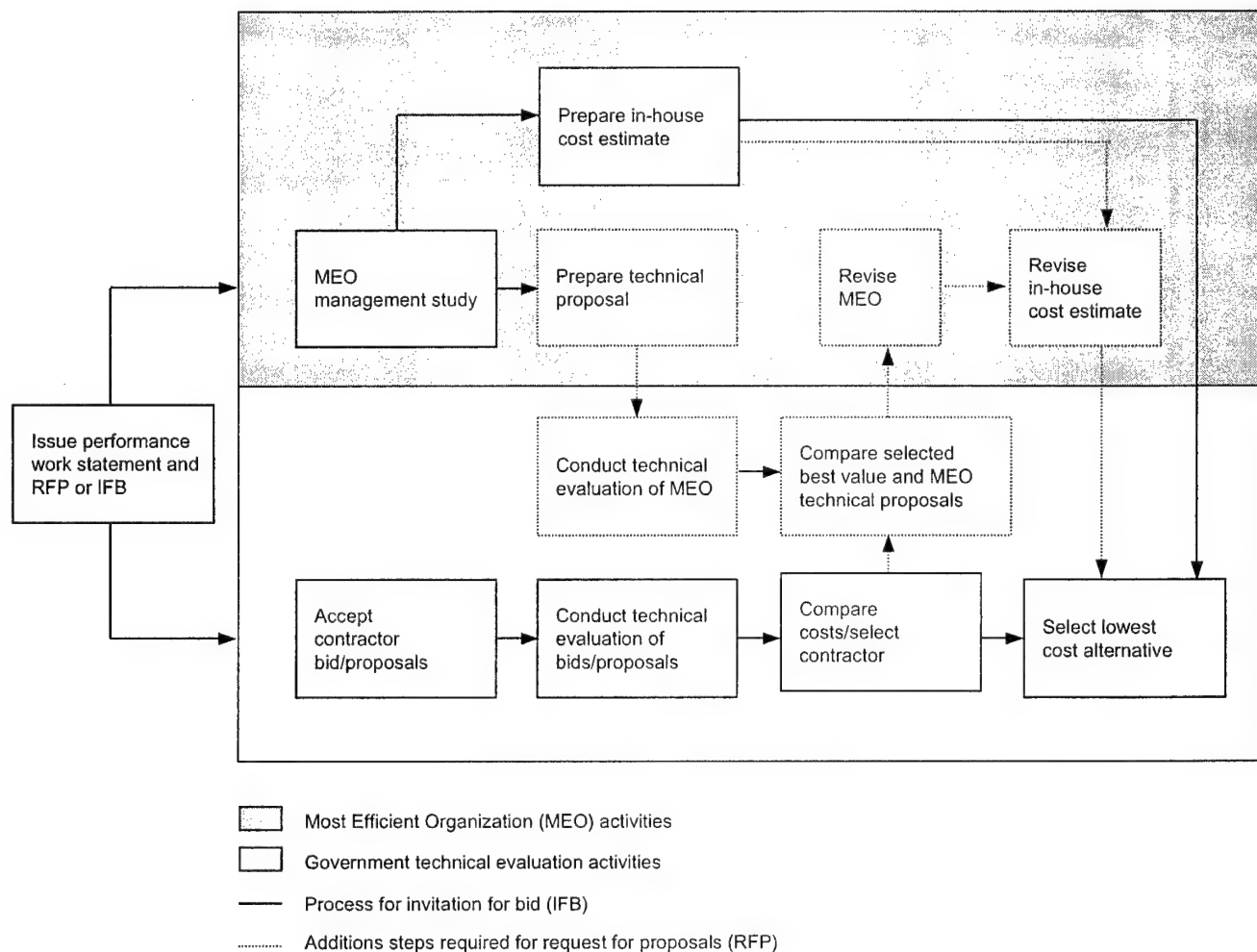
We conducted our review from September 1999 through April 2000 in accordance with generally accepted government auditing standards.

The A-76 Process

In general, the A-76 process consists of six key activities—(1) developing a performance work statement and quality assurance surveillance plan; (2) conducting a management study to determine the government's most efficient organization; (3) developing an in-house government cost estimate for the most efficient organization; (4) issuing a Request for Proposals or Invitation for Bids; (5) evaluating the proposals or bids and comparing the in-house estimate with a private sector offer or interservice support agreement and selecting the winner of the cost comparison; and (6) addressing any appeals submitted under the administrative appeals process, which is designed to ensure that all costs are fair, accurate, and calculated in the manner prescribed by the A-76 handbook.

Figure 1 shows an overview of the process. The solid lines indicate the process used when the government issues an Invitation for Bids or Request for Proposals, requesting bids or proposals on the cost of performing a commercial activity. This type of process is normally used for more routine commercial activities, such as grass-cutting or cafeteria operations, where the work process and requirements are well defined. The dotted lines indicate the additional steps that take place when the government wants to pursue a negotiated, "best value" procurement. This type of process is often used when the commercial activity involves high levels of complexity, expertise, and risk.

Figure 1: Overview of the A-76 Process



The circular requires the government to develop a performance work statement. This statement, which is incorporated into either the Invitation for Bids or Request for Proposals, serves as the basis for both government estimates and private sector offers. If the Invitation for Bids process is used, each private sector company develops and submits a bid, giving its price for performing the commercial activity. While this process is taking place, the government activity performs a management study to determine the most efficient and effective way of performing the activity with

in-house staff. Based on this “most efficient organization,” the government develops a cost estimate and submits it to the selecting authority. The selecting authority concurrently opens the government’s estimate along with the bids of all private sector firms.

If the Request for Proposals—best value process—is used, the Federal Acquisition Regulation and the A-76 supplemental handbook require several additional steps. The private sector offerors submit proposals that often include a technical performance proposal and a price. The government prepares an in-house management plan and cost estimate based strictly on the performance work statement. On the other hand, private sector proposals can offer a higher level of performance or service. The government’s selection authority reviews the private sector proposals to determine which one represents the best overall value to the government based on such considerations as (1) performance levels, (2) proposal risk, (3) past performance, and (4) price. After the completion of this analysis, the selection authority prepares a written justification supporting its decision. This includes the basis for selecting a contractor other than the one that offered the lowest price to the government. Next, the authority evaluates the government’s most efficient organization and determines whether it can achieve the same level of performance and quality as the selected private sector proposal. If not, the government must then make changes to its most efficient organization to meet the performance standards accepted by the authority. This is intended to ensure that the in-house cost estimate is based upon the same scope of work and performance levels as the best value private sector offer. After the authority determines that the most efficient organization and the private sector proposal are based on the same level of performance, the cost estimates are compared.

According to the Office of Management and Budget’s A-76 guidance, the activity will be converted to performance by the private sector if the private sector offer is either lower by an amount equal to 10 percent of the direct personnel costs of the in-house cost estimate or is \$10 million less over the performance period than the in-house estimate, whichever is less. The Office of Management and Budget established this minimum cost differential to ensure that the government would not convert performance for marginal estimated savings.

Participants in the process—for either the Invitation for Bids or Request for Proposals process—may appeal the selection authority’s decision if they believe the costs submitted by one or more of the participants were not

fair, accurate, or calculated in the manner prescribed by the A-76 handbook.

Appeals must be submitted in writing and within 20 days after the date that all supporting documentation is made publicly available. The appeal period may be extended to 30 days if the cost comparison is particularly complex. Appeals are supposed to be adjudicated within 30 days after they are received.

Strategic Sourcing

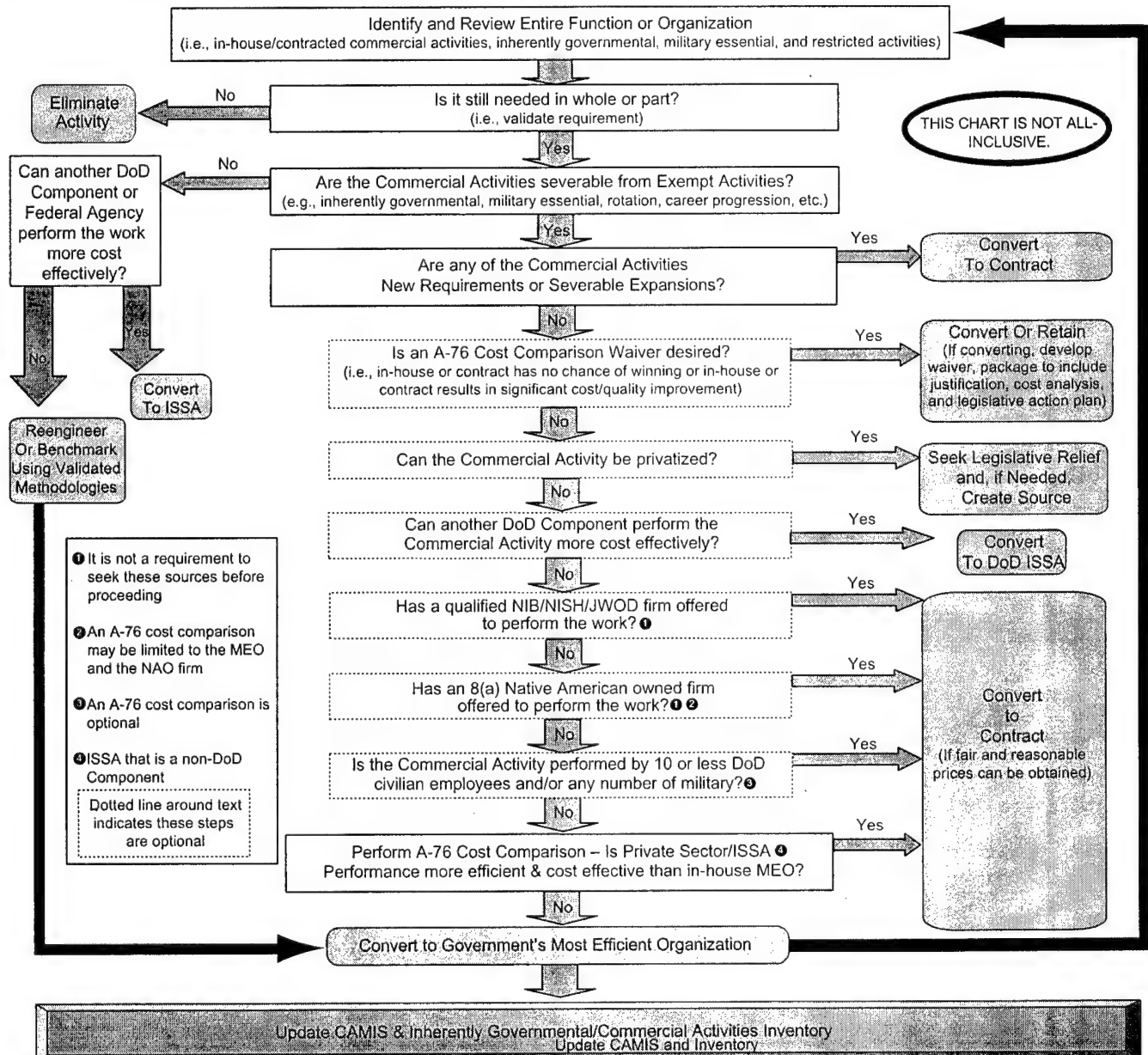
The strategic sourcing program is intended to maximize effectiveness, efficiencies, and savings throughout the Department by providing for a complete functional or organizational assessment of functions and activities that are commercial, commercial but exempt from competition, and inherently governmental.

DOD Guidance on the Use of Strategic Sourcing

The Strategic Sourcing Program represents another method available to the services to help achieve their A-76 goals. Guidance from both the Office of the Secretary of Defense and the Navy states that strategic sourcing is consistent with the goals and objectives of the reinvention process outlined in A-76, which allows the consideration of a wide range of options other than A-76 cost comparisons to determine whether processes can be eliminated, improved, or streamlined. The Office of the Secretary of Defense's interim guidance does not mandate the use of strategic sourcing, but if strategic sourcing is used to meet A-76 goals, it is subject to Office of the Secretary of Defense reporting criteria and approval. The Navy's draft guidance requires that the results from strategic sourcing be kept separate from the A-76 results. For example, savings from strategic sourcing are to be documented in a separate database that will track baseline data on milestones and amount of savings.

The key step in strategic sourcing is to properly define an entire function or activity to optimize or improve the level of performance at a reduced cost, regardless of whether the function or activity is commercial or inherently governmental. Through the use of an elaborate decision process, service components can then consider a wide range of options and combinations, including elimination of obsolete practices, consolidation, adoption of best business practices, privatization, or competitive sourcing. Functions that cannot be eliminated, combined, or converted to private sector performance are candidates for functional assessments, a process reengineering-based approach designed to achieve the most efficient operation. Figure 2 shows a graphic of the decision process.

Figure 2: Strategic Sourcing Decision Process



Source: "Strategic Sourcing Program," Department of Defense Strategic and Competitive Sourcing Program Interim Guidance (Apr. 3, 2000).

Implementation of Strategic Sourcing

At this time, the Navy is the only service with a definite plan to use the strategic sourcing program to achieve the goals of the A-76 program. Naval headquarters officials have emphasized that the strategic sourcing program is an effort driven and endorsed by naval commands, which are also responsible for execution and milestones. We visited two naval commands that are performing functionality assessments on various activities—the Naval Sea Systems Command's weapons station at Crane, Indiana, and the Naval Air Systems Command, Patuxent, Maryland.

Crane and the Naval Air Systems Command strategic sourcing efforts are based on reengineering processes. Crane's program, begun in fiscal year 1998, has served as the strategic sourcing pilot for the Naval Sea Systems Command, and its efforts contributed to the Navy's decision to pursue the use of strategic sourcing. Crane currently has 1,949 of its 3,200 (61 percent) employees under study in its strategic sourcing program and anticipates cumulative savings of \$158 million by fiscal year 2005. (Strategic sourcing is taking the place of 369 positions previously projected to be studied under A-76 at this location. Slightly more than 200 positions continue in the A-76 process.) Naval Air Systems Command officials stated that they plan to study 7,840 positions. The initial startup costs for the effort were estimated at \$32 million, to be funded from its operating budget. Net savings are budgeted at about \$395 million by fiscal year 2005. Although the services have been conducting reengineering efforts for years, Office of the Secretary of Defense officials stress the costs and amount of potential savings of strategic sourcing is still unclear.

Both the Army and Air Force have stated their intentions to consider the use of strategic sourcing to obtain the savings goals established for A-76 efforts. Both services are working with their major commands to identify potential candidates for submission in the President's Budget for Fiscal Year 2002. According to an Army program official, it is likely that the Army will propose to study about 55,000 positions through A-76 (the total is currently over 71,000) and about 16,000 under strategic sourcing (77 and 23 percent, respectively). While the number of potential candidates the Air Force is considering for strategic sourcing is about 14,000 positions, officials indicated they do not plan to lower their goal of conducting A-76 studies for 40,000 positions.

Conversely, Marine Corps officials stated they have not made any commitments to a strategic sourcing effort at this time. According to its

Appendix III
Strategic Sourcing

latest business plan, the Marine Corps is placing a strong emphasis on A-76 as the primary tool for efficiencies in commercial functions.

Comments From the Department of Defense



ACQUISITION AND
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OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

July 27, 2000

Mr. David R. Warren
Director, Defense Management Issues
National Security and International Affairs Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Warren:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "DoD COMPETITIVE SOURCING: Some Progress, but Continuing Challenges Remain to Meeting Program Goals," May 25, 2000 (GAO Code 709449/OSD Case 2019). Overall, the Department concurs with the draft report. However, we have provided detailed technical comments to Ms. Marilyn Wasleski of your staff for consideration in finalizing the report.

We partially concur with the first recommendation which states that "the Secretary of Defense [should] require DoD components to adjust their savings estimates to reflect that military positions will be retained and therefore will likely reduce expected savings." The Department views A-76 related savings as a two step process. The first step requires identifying the savings associated with A-76 initiatives and the second step is associated with reinvesting those savings to support force modernization. Historically, in the event that functions previously performed by military personnel are moved to the private sector or government MEO, the Navy and Air Force have cut their end strength. The Army, however, has chosen to program additional funds to avoid cutting end strength and facilitate transfers of the military to meet operating force shortfalls. The additional cost born by the Army is essentially a readiness bill that is not mandated by the A-76 program and therefore should not be viewed as an offset to the savings reported as a result of the competition. As the Navy, Air Force, and Marine Corps are confronted with a scenario similar to the Army end strength shortfall, we expect that they too will make the necessary investment decision.

We concur with the second recommendation which states that "the Secretary of Defense [should] require DoD components to periodically determine if savings are being realized commensurate with the reductions being made in the operating accounts." Such reviews have been conducted for the past two years by the Center for Naval Analysis (CNA) and the RAND Corporation and will continue to be sponsored by the Department in the future. The results of the CNA and RAND studies should be published in the next few months.

We believe it is also important to emphasize that recent GAO reviews on this subject all contain a similar positive message, i.e., that substantial savings are being realized and sustained, but that the exact amount of savings cannot be determined with a high level of precision. One cause of the precision problem is that the Department has not yet fully implemented Activity



Based Costing and Management (ABC/ABM) systems. This makes it very difficult to accurately determine baseline organization costs and reduces precision of savings estimates for both our competitive and strategic sourcing programs. To improve management oversight, all Military Services have ongoing efforts to develop ABC/ABM systems on a much broader scale than simply for commercial activities. The use of ABC/ABM principles by the Navy and Marine Corps to establish baseline costs for their strategic sourcing program is particularly encouraging. We expect the development of Military Service ABC/ABM systems to take several years to fully implement.

The extent to which the Department will allow the Army, Air Force and Defense Agencies to use Strategic Sourcing to help meet the study goals previously associated with the A-76 program is uncertain. Several key factors that will affect the extent of approval include: the reliability of savings projections; the level of detail provided as to which functional areas would be reviewed and the specific changes proposed in such area; the schedule for implementation; the availability of funding to implement the proposed changes; and the presence of an ongoing program for future years.

I appreciate the opportunity to comment on the draft report. If you have any questions about the technical corrections that have been provided directly to your office or our response to your recommendations, please contact my point of contact for this report, Mr. Paul Solomon at 703/602-3666.

Sincerely,



Randall A. Yim
Deputy Under Secretary
(Installations)

GAO Contacts and Staff Acknowledgments

GAO Contacts

Barry Holman (202) 512-5581
Marilyn Wasleski (202) 512-8436

Acknowledgments

In addition to those named above, Debra McKinney, David Rowan, and Arnett Sanders made key contributions to this report.

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